Senate Fiscal Agency

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BALLOT PROPOSAL 06-5

An Overview

Prepared by
Kathryn Summers-Coty,
Chief Analyst

Gary S. Olson, Director

Phone (517) 373-2768
TDD (517) 373-0543

http://www.senate.michigan.gov/sfa

On November 7, 2006, Michigan voters will decide whether to amend the State School Aid Act of 1979, to require inflationary increases in appropriations for K-12, community colleges, and higher education, and fund specific guarantees within the K-12 budget.

Proposal 06-5 is the result of a citizens' initiative petition circulated among electors for qualifying signatures. An initiative petition first is presented to the Legislature, which has 40 days to enact or reject the proposal. Since the Legislature chose to take no action, voters will have the opportunity to vote on the following ballot language:

PROPOSAL 06-5

A LEGISLATIVE INITIATIVE TO ESTABLISH MANDATORY SCHOOL FUNDING LEVELS

The proposed law would:

- *Increase current funding by approximately $565 million and require State to provide annual funding increases equal to the rate of inflation for public schools, intermediate school districts, community colleges, and higher education (includes state universities and financial aid/grant programs).*
- *Require State to fund any deficiencies from General Fund.*
- *Base funding for school districts with a declining enrollment on three-year student enrollment average.*
- *Reduce and cap retirement fund contribution paid by public schools, community colleges and state universities; shift remaining portion to state.*
- *Reduce funding gap between school districts receiving basic per-pupil foundation allowance and those receiving maximum foundation allowance.*

Should this proposal be adopted?

If a majority of electors vote "yes", the State School Aid Act will be amended.

Discussion

To summarize, the initiative annually requires the following funding levels and guarantees beginning October 1, 2007:

1) Inflationary bottom-line spending increases in K-12, community colleges, and higher education.

2) For K-12: using a three-year average pupil blend for all declining enrollment districts, ensuring an inflationary increase in the basic foundation allowance, closing the foundation allowance gap by $300 over six years, and providing inflationary increases in at-risk, intermediate school district (ISD) operations, and special education.

3) Capping schools', community colleges', and universities' contributions to the Michigan Public School Employees Retirement System (MPSERS) at the lesser of 80.0% of the actual retirement rate or 14.87% applied to payroll, requiring the State to pay the difference between the local contribution and the actual retirement rate.

Guaranteed Operational Funding

The first section requires an inflationary increase for fiscal year (FY) 2006-07 in gross State spending for K-12 from the 2004-05 fiscal year, and an inflationary increase in gross appropriations for community colleges and higher education as found for FY 2004-05 in Public Acts 358 and 352 of 2004, respectively. The consensus estimate of inflation as measured by the

U.S. Consumer Price Index and reached at the May 2006 Consensus Revenue Estimating Conference is 6.5% over that two-year period. The necessary baseline increase in FY 2006-07 for all three components (K-12, community colleges, and higher education) is estimated at $180.3 million above the gross appropriation levels recently enacted for those budgets.

The second portion of the petition requires specific "guarantees" in funding. These guarantees include an inflationary increase in the basic foundation allowance, Proposal A obligation payment, discretionary payment, at-risk grant, special education funding, and ISD operational funding. The FY 2006-07 School Aid budget sets the basic foundation allowance at $7,085; the initiative would require an additional $51 per pupil to meet the inflationary increase requirement, bringing the basic foundation allowance to $7,136. Also, the initiative includes a "declining enrollment" provision for all school districts. In this guarantee, an average of the prior three years' pupil membership blends, rather than the current-year membership blend alone, would be the basis for State aid payments, if the three-year blend yielded a higher pupil number. Finally, on the operational funding side, the initiative contains a provision to reduce the State funding gap between the basic foundation allowance and the maximum foundation allowance (currently $1,300) to $1,000 over a period of six years. This analysis assumes the $300 gap closure would occur in equal $50 increments over each of the next six years, though the initiative is silent on actual implementation.

● Note: The increase in gross baseline funding for K-12 required by the initiative, combined with the existing dollars available in "discretionary" or "nonrequired" categoricals appropriated in the K-12 budget would provide sufficient funding to pay for the specific funding "guarantees" listed above *provided that* some of the existing School Aid discretionary categoricals were reduced from their FY 2006-07 level and new items in the budget were not funded. In other words, existing and new program funds not guaranteed by the initiative (e.g., adult education, school readiness, or middle school math grants) could be used to offset the costs of the specific funding guarantees that are required by the initiative. However, if the initiative's costs were simply added *on top of* the FY 2006-07 enacted School Aid budget, then the costs of funding all of the currently-enacted programs *plus* the K-16 requirements would be $141.7 million more than the $180.3 million noted above, or $322.0 million.

Retirement Contributions: State and Local Portions

Turning to retirement funding under the initiative, the local portion of the contributions made by districts, ISDs, community colleges, and participating universities into the Michigan Public School Employees Retirement System would be capped at the lesser of 80.0% of the actual retirement rate or 14.87% (the FY 2004-05 rate) applied to payroll; the State would pay the difference to the MPSERS. The FY 2006-07 rate for K-12 and community colleges estimated in the School Aid budget is 17.74%, meaning the local contribution would be capped at 14.19% of payroll and the State would have to pay 3.55% of payroll, estimated at $371.9 million.

For participating universities, the total cost to be paid into the retirement system is estimated at $44.4 million, which equates to 22.01% of payroll. Thus, the participating universities' contribution to the MPSERS would be capped at 14.87%, and the State contribution to the MPSERS for participating universities is estimated at 7.14% of payroll, for a State cost of $14.4 million. Combining the State costs for K-12, community colleges, and universities yields a total estimated retirement cost of $386.3 million.

Fiscal Impact of the Initiative

Table 1 shows for K-12, community colleges, and higher education the estimated required operational and retirement costs to the State in FY 2006-07, compared with the appropriation levels enacted in those three budgets for FY 2006-07. As mentioned above, the cost reflected in Operations for K-12 uses many of the FY 2006-07 appropriations in *nonrequired* categoricals to offset the *mandated* costs of the K-16 proposal.

Table 1

Estimated Operational[1] and MPSERS Costs in FY 2006-07 Compared with FY 2006-07 Gross Appropriations (Dollars in Millions)				
	K-12	**Community Colleges**	**Higher Education**	**Total**
Operations[1]	$153.4	$14.4	$12.5	$180.3
MPSERS	352.9	19.0	14.4	$386.3
Total..	**$506.3**	**$33.4**	**$26.9**	**$566.6**

1) Operations estimate for K-12 assumes eliminating new items and reducing some existing discretionary (i.e., non-guaranteed) categoricals in the FY 2006-07 K-12 budget below the levels appropriated for FY 2006-07. Also, "Operational" or "Operations" means standard operations funding plus any other State appropriations in the three budgets.

Table 1 indicates a total cost to meet the requirements of the initiative petition, combining K-12, community colleges, and higher education, of $566.6 million above the actual FY 2006-07 gross appropriations. Of that total, 68.2% is represented by the required State contribution to the MPSERS, and 31.8% is devoted to operational costs.

For years beyond FY 2006-07, it is likely that the MPSERS component of the K-16 funding initiative would comprise the bulk of the costs to the State. Once the base "operational" funding floors for K-12, higher education, and community colleges were established and funded in FY 2006-07, State revenue in FY 2007-08 and beyond, at least in the School Aid Fund, likely would increase at least by the rate of inflation and could pay for the required inflationary operational increases. Thus, the additional cost of the initiative in FY 2007-08 probably would be less than the $566.6 million estimated for FY 2006-07, but would depend upon the amount of the State contributions required to be paid to the MPSERS. In FY 2007-08 and beyond, retirement costs would continue to be a financial burden on the State as the MPSERS rate and participating entities' payrolls rise.